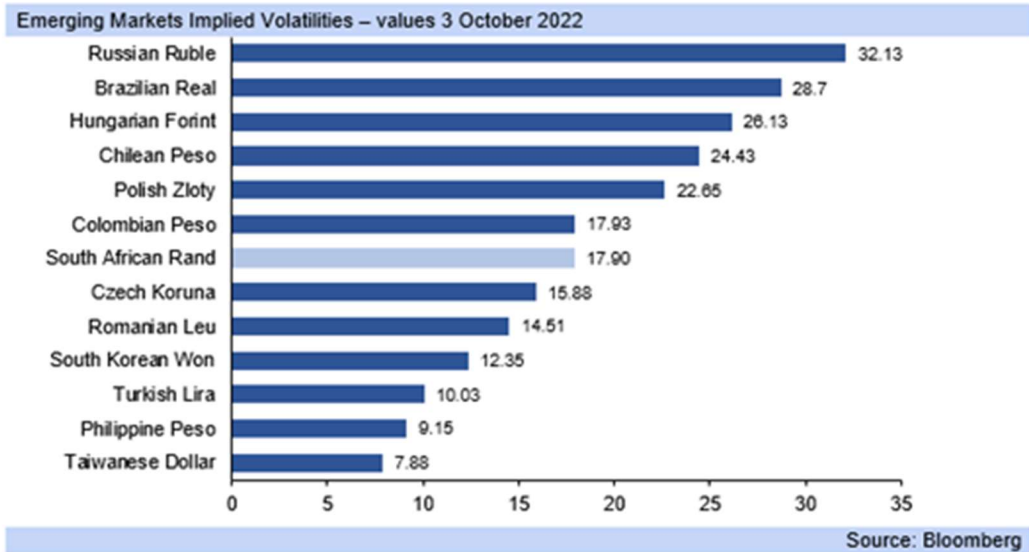




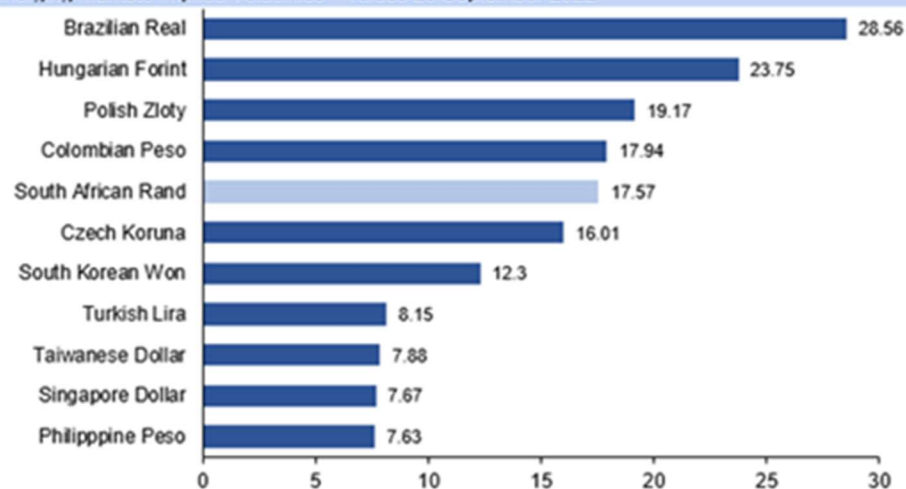
SA Economics

Monday 3 October 2022

Rand note: the lengthy approach, and increased likelihood of global recession has elevated and prolonged the risk-off environment

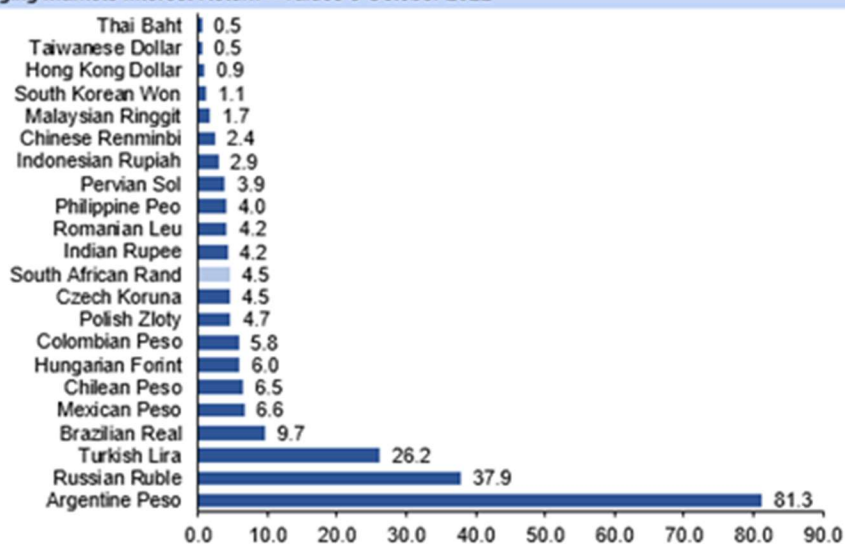


Emerging Markets Implied Volatilities – values 26 September 2022

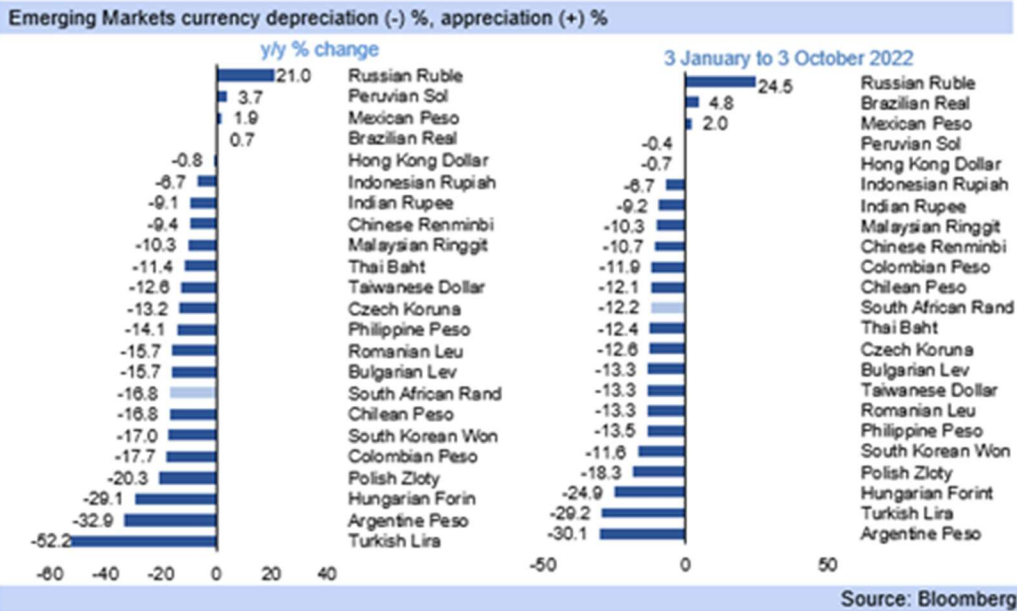


Source: Bloomberg

Emerging Markets Interest Return – values 3 October 2022



Source: Bloomberg



Expected Case: Exchange Rate forecasts

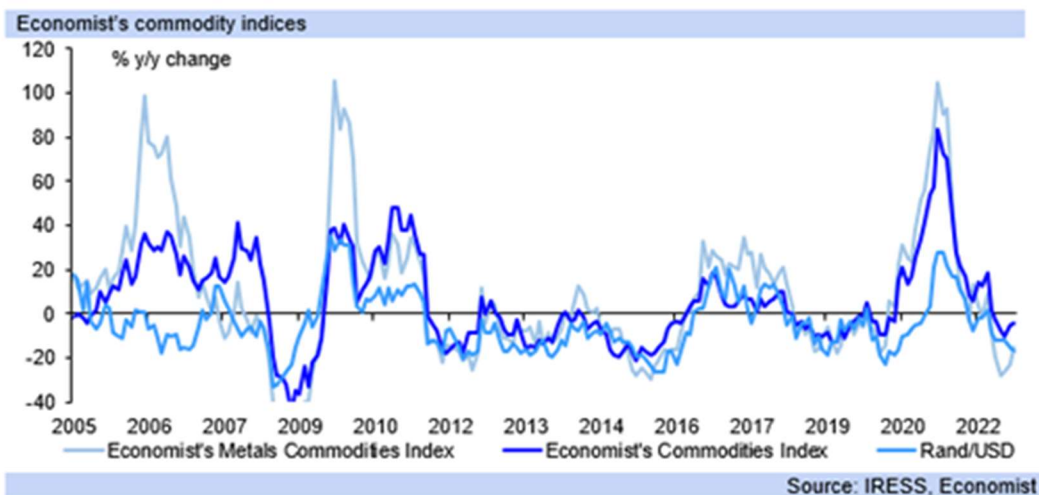
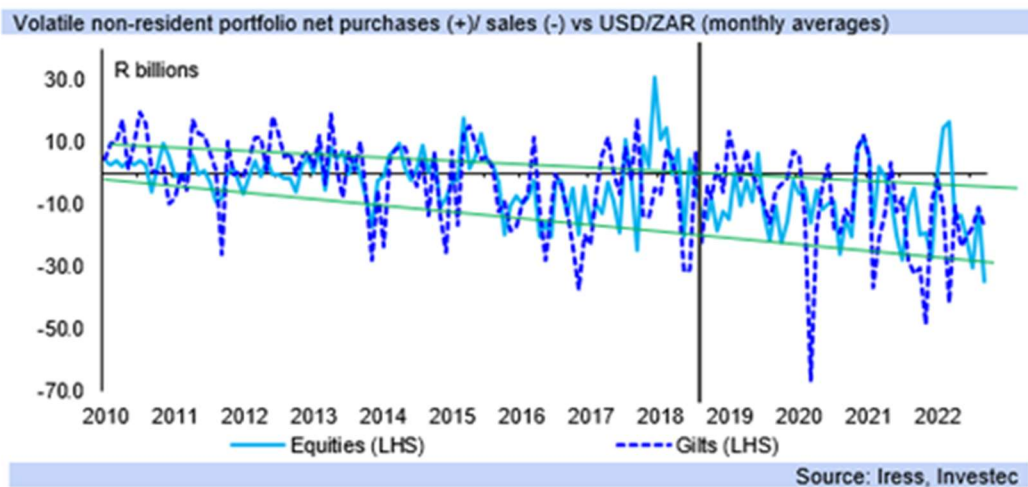
	2022				2023				2024			
	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.59	17.05	16.80	16.60	17.00	17.40	16.90	16.70	17.20	17.70	17.20
GBP/ZAR	20.40	19.59	20.06	17.22	16.93	17.94	18.97	19.10	19.71	21.50	23.36	23.74
EUR/ZAR	17.07	16.60	17.16	16.46	16.77	17.77	18.62	18.42	18.70	19.78	20.89	21.16
ZAR/JPY	7.65	8.33	8.12	8.45	8.37	8.03	7.67	7.75	7.66	6.98	6.50	6.40
CHF/ZAR	16.47	16.16	17.64	16.63	16.93	17.85	18.43	17.80	17.96	18.90	19.45	18.90
AUD/ZAR	11.02	11.14	11.65	11.09	11.37	12.16	12.88	12.84	13.03	13.42	13.81	13.42
GBP/USD	1.34	1.26	1.18	1.03	1.02	1.06	1.09	1.13	1.18	1.25	1.32	1.38
EUR/USD	1.12	1.06	1.01	0.98	1.01	1.05	1.07	1.09	1.12	1.15	1.18	1.23
USD/JPY	116	130	138	142	139	137	134	131	128	120	115	110

Note: averages, Source: Investec, Iress

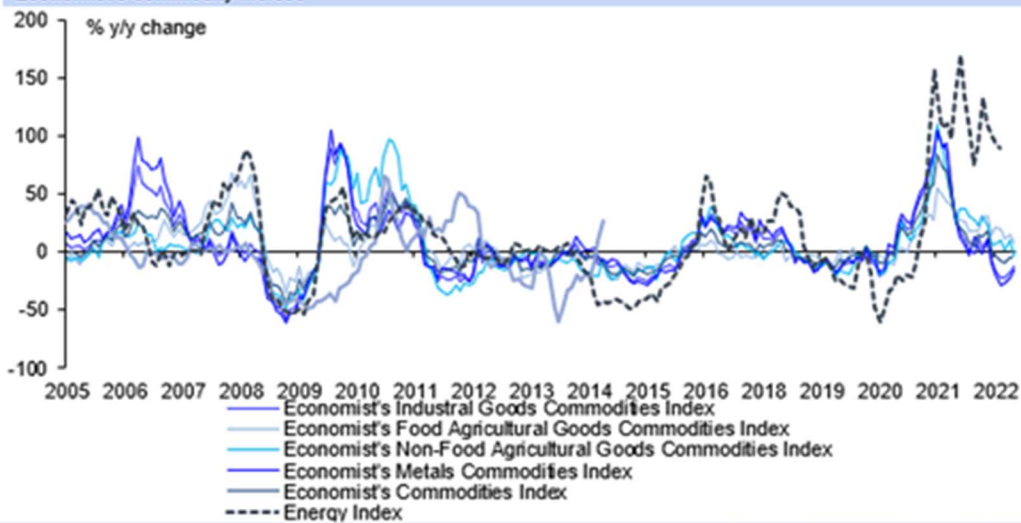
- With the rand attempting to settle around R18.00/USD, markets await new direction as the next FOMC meeting only occurs in November, currently factoring in less than a 75bp hike for November (66bp currently), and close to 50bp in December (46bp).
- The US's interest rate hike cycle has been unusually fast and substantial, purposely so in order to attempt to quell high inflation and inflation expectations, although markets have expected that the size of the US rate hikes could reduce in Q4.22 (to 50bp a meeting).
- A week ago the implied Fed funds futures were factoring in a 70bp lift in November, higher than current market expectations, and for December 48.5%, also higher than currently for the end of the year, as market expectations have slipped somewhat over the past week.
- However, the rand has not gained from the easing over the past week in markets expectations on future US interest rate hikes, with the rand averaging R18.03/USD (R17.492/EUR, R19.52/GBP) last week, versus R17.73/USD (R17.50/EUR, R19.92/GBP) the week before.
- The rand has also lost ground as Eskom continues to face unresolved difficulties in increasing the availability of electricity in the face of vandalism, theft and sabotage of its infrastructure and electricity generation capacity, on old poorly maintained, or poorly built power stations.

- The newly reconfigured Eskom board did not spark rand strength, as the deep rooted problems in SA's energy production sector are not quick or easy to resolve, but will instead take many years to repair, resolve and bolster domestic production capacity.
- South Africa has also seen a declining terms of trade since March this year as trade dynamics weakened into Q2.22 and over Q3.22, lowering economic growth expectations, along with slowing global growth (growing chance of recession) expected.
- The long lead time to the advent of global recession has caused a prolonged, and worsening period of risk aversion, with this market risk-off in particular the driver of rand weakness and USD strength, and which is not expected to ease in the near term.
- While markets are factoring in a slowing in US interest rate hikes, risk aversion is at such high levels of elevation that this has not caused a calming effect, with the focus on recession risk and its particularly slow approach, in turn exacerbating risk aversion even further.

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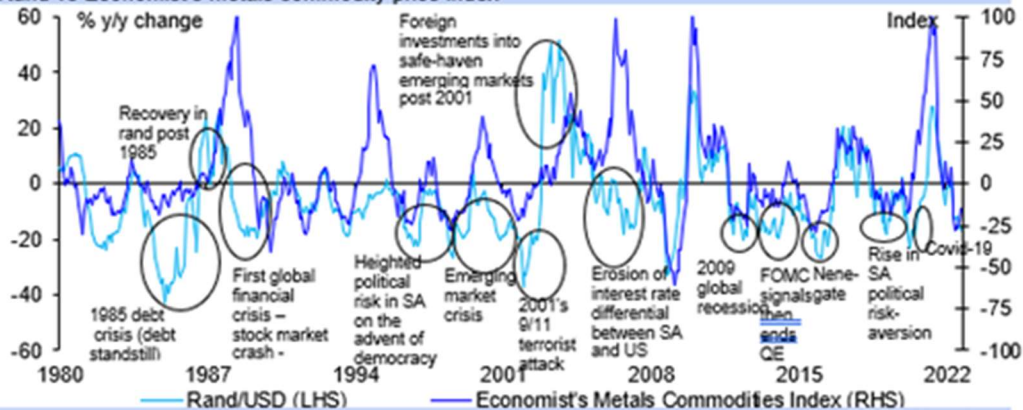


Economist's commodity indices



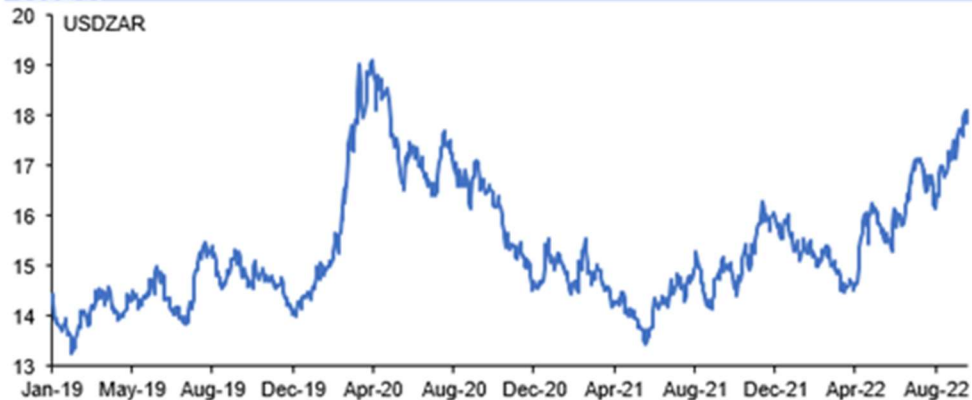
Source: IRESS, Economist, IMF

Rand vs Economist's metals commodity price index



Source: IRESS, Investec

USDZAR



Source: Iress

- Indeed the extremely hawkish tone of Central Banks is a key risk driver of a significant recession, particularly the Fed, with US monetary policy tending to drive, or at least significantly influence, those of other Central Banks.
- A calming in the tone of the US Fed would do much to alleviate the negative cycle investor sentiment has fallen into, while policy missteps add to market turmoil and so negative investor sentiment.
- British Prime Minister Liz Truss and Finance Minister Kwasi Kwarteng have succumbed to market pressure for an early release of an updated version of the OBR (Office for Budget Responsibility) fiscal and economic forecasts, extending investor concerns over the plan.
- Recent weak Q2.22 UK (revised) growth estimates kept the economy from recession, but Q3.22 is expected to see a contraction (on the extra public holiday as growth is already so weak) with Q4.22 and Q1.23 expected to see further drops in activity.
- In the EU, inflation has reached 10% y/y, for September (expected 9.7% y/y, previous 9.1% y/y), with broadening price pressures strengthening market expectations for another large ECB hike, but increasing recession concerns, while energy costs rose 41% y/y.
- The increasingly heavy pressure on indebted consumers is a key concern, but so is the impact of the severe risk off sentiment on indebted emerging market and developing countries, with these economies already negatively impacted by the withdrawal of investor appetite.
- Fed Vice Chair Brainard has warned that “the global environment of high inflation and rising interest rates highlights the importance of paying attention to financial stability considerations for monetary policy”, with Central banks tasked with maintaining financial market stability.
- “As monetary policy tightens globally to combat high inflation, it is important to consider how cross-border spillovers and spillbacks might interact with financial vulnerabilities,” with the Fed “attentive” to vulnerabilities “exacerbated by the advent of additional adverse shocks.”
- With Central Banks still to pull back on aggressively hawkish monetary policy stances, the rand lost further ground over the past week, and is at risk of further marked weakness and in particular of pulling towards the severe down case, pushing its probability to 11%.

Economic Scenarios: note updated probabilities

		Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23
Extreme Up case 1%	USD/Rand (average)	15.21	15.59	17.05	15.40	14.50	14.00	13.60	13.40
	Repo rate (end rate)	4.25	4.75	6.25	4.50	4.00	3.75	3.75	3.50
	SA economic growth rises to 3–5%, then 5–7%. Good governance, growth-creating reforms (structural constraints eradicated), strong property rights, no nationalisation or expropriation without compensation. High business confidence and fixed investment growth, substantial FDI, fiscal consolidation drives debt to low ratios of 2000s. Very subdued domestic inflation on extreme rand strength, very favourable weather conditions. Strong global growth, risk-on, commodity boom. Rapid upgrades of credit ratings. Strong transition away from fossil fuel usage, a quick transition to renewable energy.								
Up case 1%	USD/Rand (average)	15.21	15.59	17.05	16.00	15.30	15.00	14.70	14.60
	Repo rate (end rate)	4.25	4.75	6.25	4.75	4.50	4.25	4.25	4.25
	Economic growth of 3%, rising confidence and investment levels, structural constraints eroded, global growth strong, global financial markets risk-on. No nationalisation or expropriation without compensation. Low domestic inflation on favourable weather and global conditions, rand strength, lower state-controlled price inflation on increased private privatisation. Positive outlooks on credit ratings turn into upgrades fiscal consolidation, debt projections fall substantially. Substantial transition to renewable energy away from fossil fuel usage, comprehensive measures to alleviate climate change impact on economy.								
Base case 48%	USD/Rand (average)	15.21	15.59	17.05	17.30	17.60	17.40	17.00	16.90
	Repo rate (end rate)	4.25	4.75	6.25	7.00	7.50	7.50	7.25	7.00
	Economic growth modest but lifts towards 3.0% y/y over five years on sufficient domestic policy support measures, global financial market risk sentiment is neutral to positive. South Africa in the BB credit rating category bracket as fiscal consolidation (debt to GDP stabilisation) occurs leading to some positive outlooks. The rand sees mild weakness and inflation is impacted by the course of weather patterns via food price inflation. Little expropriation without compensation occurs and has no negative effect on economy, no nationalisation. A modest transition to renewable energy and slow move away from fossil fuel usage occurs and measures to alleviate the impact of climate change on the economy are modestly implemented. The Russian/Ukraine conflict eases and does not exacerbate.								
Lite Down case 39%	USD/Rand (average)	15.21	15.59	17.05	17.40	17.70	17.80	17.70	17.90
	Repo rate (end rate)	4.25	4.75	6.25	7.50	8.00	8.50	9.00	9.00
	The international environment (incl. risk sentiment) is that of the base case. South Africa fails to see debt projections stabilise, falls into single B (local and foreign currency) credit ratings from all three agencies. Recession occurs. Business confidence depressed, significant load shedding, weak investment growth, civil and political unrest. High inflation on unfavorable weather conditions, marked rand weakness. Little transition to renewable energy or measures to alleviate the impact of climate change. Very limited expropriation of private sector property without compensation, with some negative impact on the economy. Substantial fiscal consolidation ultimately occurs, preventing ratings falling into the C grades.								
Severe down case 11%	USD/Rand (average)	15.21	15.59	17.05	18.00	18.30	18.50	18.60	19.00
	Repo rate (end rate)	4.25	4.75	6.25	8.00	9.00	10.00	10.50	10.50
	Lengthy global recession, global financial crisis – insufficient monetary and other support domestically and internationally. Limited expropriation of private property without compensation with a marked negative economic impact. Very high inflation on very adverse weather conditions, severe rand weakness. SA rated single B from all three key agencies, downgrades eventually into CCC grade, increased risk of default. Government borrows from increasingly wider sources, sinks deeper into a debt trap, widespread, severe services load shedding, severe civil and political unrest. SA economy in depression. Failure to transition to renewable energy and to sufficient measures to alleviate the impact of climate change on the economy.								

Note: Event risk begins Q4.22. Source: Investec

Lite Down Case: Exchange Rate forecasts

	2022				2023				2024			
	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.59	17.05	17.40	17.70	17.80	17.70	17.90	18.10	18.20	18.20	18.00
GBP/ZAR	20.40	19.59	20.06	17.84	18.05	18.78	19.29	20.23	21.36	22.75	24.02	24.84
EUR/ZAR	17.07	16.60	17.16	17.05	17.88	18.60	18.94	19.51	20.27	20.93	21.48	22.14
ZAR/JPY	7.65	8.33	8.12	8.16	7.85	7.67	7.54	7.32	7.07	6.59	6.32	6.11
CHF/ZAR	16.47	16.16	17.64	17.22	18.05	18.69	18.75	18.85	19.46	20.00	20.00	19.78
AUD/ZAR	11.02	11.14	11.65	11.48	12.12	12.73	13.10	13.60	14.12	14.20	14.20	14.04
GBP/USD	1.34	1.26	1.18	1.03	1.02	1.06	1.09	1.13	1.18	1.25	1.32	1.38
EUR/USD	1.12	1.06	1.01	0.98	1.01	1.05	1.07	1.09	1.12	1.15	1.18	1.23
USD/JPY	116	130	138	142	139	137	134	131	128	120	115	110

Note: averages, Source: Investec, Iress

Severe Down Case: Exchange Rate forecasts												
	2022				2023				2024			
	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.59	17.05	18.00	18.30	18.50	18.60	19.00	19.30	19.40	19.30	19.30
GBP/ZAR	20.40	19.59	20.06	18.45	18.67	19.52	20.27	21.47	22.77	24.25	25.48	26.63
EUR/ZAR	17.07	16.60	17.16	17.64	18.48	19.33	19.90	20.71	21.62	22.31	22.77	23.74
ZAR/JPY	7.65	8.33	8.12	7.89	7.60	7.38	7.18	6.89	6.63	6.19	5.96	5.70
CHFZAR	16.47	16.16	17.64	17.82	18.66	19.43	19.71	20.01	20.75	21.32	21.21	21.21
AUDZAR	11.02	11.14	11.65	11.88	12.54	13.23	13.76	14.44	15.05	15.13	15.05	15.05
GBP/USD	1.34	1.26	1.18	1.03	1.02	1.06	1.09	1.13	1.18	1.25	1.32	1.38
EUR/USD	1.12	1.06	1.01	0.98	1.01	1.05	1.07	1.09	1.12	1.15	1.18	1.23
USD/JPY	116	130	138	142	139	137	134	131	128	120	115	110

Note: averages, Source: Investec, Iress

Up Case: Exchange Rate forecasts												
	2022				2023				2024			
	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.59	17.05	16.00	15.30	15.00	14.70	14.60	14.50	14.90	15.00	14.50
GBP/ZAR	20.40	19.59	20.06	16.40	15.61	15.83	16.02	16.50	17.11	18.63	19.80	20.01
EUR/ZAR	17.07	16.60	17.16	15.68	15.45	15.68	15.73	15.91	16.24	17.14	17.70	17.84
ZAR/JPY	7.65	8.33	8.12	8.88	9.08	9.10	9.08	8.97	8.83	8.05	7.67	7.59
CHFZAR	16.47	16.16	17.64	15.84	15.60	15.75	15.57	15.38	15.59	16.37	16.48	15.93
AUDZAR	11.02	11.14	11.65	10.56	10.48	10.73	10.88	11.10	11.31	11.62	11.70	11.31
GBP/USD	1.34	1.26	1.18	1.03	1.02	1.06	1.09	1.13	1.18	1.25	1.32	1.38
EUR/USD	1.12	1.06	1.01	0.98	1.01	1.05	1.07	1.09	1.12	1.15	1.18	1.23
USD/JPY	116	130	138	142	139	137	134	131	128	120	115	110

Note averages, Source: Investec, Iress

Extreme Up Case: Exchange Rate forecasts												
	2022				2023				2024			
	Q1.22	Q2.22	Q3.22	Q4.22	Q1.23	Q2.23	Q3.23	Q4.23	Q1.24	Q2.24	Q3.24	Q4.24
USD/ZAR	15.21	15.59	17.05	15.40	14.50	14.00	13.60	13.40	13.30	13.10	13.10	12.90
GBP/ZAR	20.40	19.59	20.06	15.79	14.79	14.77	14.82	15.14	15.69	16.38	17.29	17.80
EUR/ZAR	17.07	16.60	17.16	15.09	14.65	14.63	14.55	14.61	14.90	15.07	15.46	15.87
ZAR/JPY	7.65	8.33	8.12	9.22	9.59	9.75	9.82	9.78	9.62	9.16	8.78	8.53
CHFZAR	16.47	16.16	17.64	15.24	14.79	14.70	14.41	14.11	14.30	14.40	14.40	14.18
AUDZAR	11.02	11.14	11.65	10.16	9.93	10.01	10.06	10.18	10.37	10.22	10.22	10.06
GBP/USD	1.34	1.26	1.18	1.03	1.02	1.06	1.09	1.13	1.18	1.25	1.32	1.38
EUR/USD	1.12	1.06	1.01	0.98	1.01	1.05	1.07	1.09	1.12	1.15	1.18	1.23
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